



Australian Energy Regulator

**Review of Ausgrid's
proposed Distribution Cost
Allocation Method**

January 2014

This report contains 15 pages

AER Ausgrid CAM FINAL 220114

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1 Executive Summary

Ausgrid has submitted a proposed Cost Allocation Method to the Australian Energy Regulator (AER) for its next regulatory control period, commencing on 1 July 2014 in order to address the requirements of:

- part F of Chapter 6 of the current National Electricity Rules (NER); and
- the AER's Cost Allocation Guidelines.

This is the first time that Ausgrid has submitted a Cost Allocation Method:

- to the AER for approval; and
- under these regulatory requirements.

The AER has engaged KPMG to assess whether Ausgrid's proposed Cost Allocation Method meets the regulatory requirements.

On the basis of our analysis detailed in sections 4.1 to 4.4 of this report, we conclude that Ausgrid's proposed Cost Allocation Method meets the regulatory requirements. In particular, the proposed Cost Allocation Method:

- contains the required contents of a cost allocation method; and
- satisfies the requirements in relation to cost allocation principles and policies.

We therefore do not consider that the AER needs to require Ausgrid to make any changes to its proposed Cost Allocation Method in order to approve it as complying with the relevant regulatory requirements.

2 Our purpose and approach

This section details the purpose of, and approach to preparing, this report.

2.1 Purpose of this report

Ausgrid has submitted a proposed Cost Allocation Method to the AER for its next regulatory control period, commencing on 1 July 2014.

The purpose of this report is to:

- present the findings of our review of the extent to which Ausgrid's proposed Cost Allocation Method gives effect to, and is consistent with, relevant regulatory requirements – these requirements are discussed in section 3 of this report; and
- recommend what changes, if any, the AER may require Ausgrid to make to its proposed Cost Allocation Method before it agrees to approve it.

2.2 Approach to preparing this report

We have conducted our review, and prepared this report, using the following approach:

- we identified the relevant regulatory requirements;
- we reviewed the first draft of Ausgrid's proposed Cost Allocation Method (dated June 2012) based on the identified regulatory requirements;
- we provided the outcomes of our review of this first draft to the AER and discussed them with them – the AER, in turn, provided these outcomes to Ausgrid for its consideration;
- we met with Ausgrid (and the AER) to discuss the outcomes of our first review;
- we reviewed the second draft of Ausgrid's proposed Cost Allocation Method (dated June 2013) – this followed Ausgrid's withdrawal of its first draft;
- we provided the outcomes of our review of this second draft to the AER and discussed them with them – the AER, in turn, provided these outcomes to Ausgrid for its consideration; and
- we reviewed a third draft of Ausgrid's proposed Cost Allocation Method (dated November 2013).

The findings and recommendations in this report reflect our review of Ausgrid's third draft Cost Allocation Method, hereafter referred to in this report as its proposed Cost Allocation Method.

The remainder of this report is structured as follows:

- section 3 details the relevant regulatory requirements; and
- section 4 presents our analysis, findings and conclusion.

3 Relevant regulatory requirements

This section details the regulatory requirements that are relevant to the AER's assessment of Ausgrid's proposed Cost Allocation Method.

3.1 Functions and Powers of the AER

The AER is Australia's national energy market regulator and is an independent statutory authority. The AER's regulatory functions and powers are specified in the National Electricity Law (NEL), which is a schedule to the *National Electricity (South Australia) Act 1996*. These functions and powers include "AER economic regulatory function or power". This term is defined in the NEL as:

a function or power performed or exercised by the AER under this Law or the Rules that relates to—

- (a) *the economic regulation of services provided by—*
 - (i) *a regulated distribution system operator by means of, or in connection with, a distribution system.*

Ausgrid is a distribution network service provider (DNSP) in New South Wales (NSW). The AER is therefore responsible for the economic regulation of Ausgrid. One element of economic regulation relates to cost allocation.

3.2 Applicable National Electricity Rules

Chapters 6 and 11 of the NER deal with the economic regulation of electricity distribution services provided by DNSPs.

Rule 11.15 of the NER provides that transitional rules apply to the economic regulation of the NSW and ACT DNSPs for their current regulatory control period, 1 July 2009 to 30 June 2014. Appendix 1 of Chapter 11 details the form of Chapter 6 of the NER (transitional Chapter 6) that applies to this period. In relation to cost allocation:

- rule 6.15.5 provides that the Independent Pricing and Regulatory Tribunal's (IPART) "Accounting Separation Code for Electricity Distributors in NSW" applies to the NSW DNSPs; and
- rule 6.15.7 details the transitional cost allocation principles that apply to Ausgrid.

The AER approved Ausgrid's Cost Allocation Method under the transitional Chapter 6 for the current regulatory control period.

On 29 November 2012, the Australian Energy Market Commission (AEMC) published:

- changes to Chapter 6 of the NER (new Chapter 6); and
- new transitional arrangements in Division 2 of Part ZW of Chapter 11 of the NER that will apply to the NSW and ACT DNSPs' next regulatory control period that commences on 1 July 2014.

The result of these rule changes is that the AER will make separate regulatory determinations for the NSW and ACT DNSPs for:

- a one year transitional regulatory control period, 1 July 2014 to 30 June 2015; and
- a subsequent regulatory control period commencing on 1 July 2015.

3.3 Requirements of Part F of the new Chapter 6

A further result of the rules changes published on 29 November 2013 is that the cost allocation provisions in Part F of the new Chapter 6 of the NER will apply to Ausgrid for the first time from 1 July 2014.

Part F of the new Chapter 6 of the NER includes the following key provisions:

- rule 6.15.1 requires a DNSP to comply with a cost allocation method approved by the AER under rule 6.15;
- rule 6.15.2 details the cost allocation principles;
- rule 6.15.3 requires the AER to prepare Cost Allocation Guidelines and details matters about their contents and form; and
- rule 6.15.4 requires a DNSP to prepare a Cost Allocation Method and details matters about the timing of their preparation, the need for their consistency with the Cost Allocation Guidelines, their approval by the AER and their amendment.

3.4 AER's Cost Allocation Guidelines

In June 2008, the AER made Cost Allocation Guidelines in accordance with Rule 6.15.3(a) of the NER. These remain the current Cost Allocation Guidelines and have not been amended following the introduction of the new Chapter 6 of the NER.

There is considerable overlap, and in some cases duplication, between the requirements of the Cost Allocation Guidelines and Part F of the new Chapter 6.

The Cost Allocation Guidelines are structured as follows:

- section 1 details the nature of, and authority for, the Guidelines;
- section 2 details the requirements and principles for a DNSP attributing costs directly to, or allocating costs between, categories of distribution services;
- section 3 details the requirements for a DNSP preparing and submitting a cost allocation method to the AER;
- section 4 details the basis for the AER approving or rejecting a proposed cost allocation method; and
- section 5 details how an approved cost allocation method must be applied.

3.5 Assessment of Cost Allocation Method

As a consequence of the above, an assessment of Ausgrid's proposed Cost Allocation Method needs to consider the regulatory requirements of:

- Part F of the new Chapter 6 of the NER; and
- The AER's Cost Allocation Guidelines.

4 Analysis and findings

This section presents, in a tabular form, our analysis and findings of whether Ausgrid's proposed Cost Allocation Method gives effect to, and is consistent with, Part F of the new Chapter 6 of the NER and the AER's Cost Allocation Guidelines. The table:

- details the relevant clause of the NER and the Guidelines and summarises its requirements;
- states our finding about whether or not the relevant clause has been satisfactorily addressed; and
- comments on our finding by reference to the relevant section of the proposed Cost Allocation Method.

4.1 General obligations

Rules	CAG	Requirements	Addressed
6.15.4(a)	1.5, 3.3	DNSP must develop a proposed CAM for submission to the AER	Yes
6.15.4(b)	1.5	DNSP's proposed CAM must give effect to and be consistent with the CAG	Yes

4.2 Contents of Cost Allocation Method

CAG	Requirement	Addressed	Comments
3.2(a)(1)	Version number	Yes	Refer to contents page
3.2(a)(2)	DNSP's commitment to history and date of issue	Yes	Refer to contents page – date of issue and version history included.
3.2(a)(3)	Statement of nature, scope and purpose of document and way it is to be used	Yes	Refer to Section 2 on page 4 – sets out the nature, scope and purpose of the CAM.
3.2(a)(3)A	Accountabilities for implementation	Yes	Refer to Section 3 on page 5 – details responsibility for the CAM, including governance and approval.
3.2(a)(3)B	Responsibilities for updating, maintaining and applying document and for internally monitoring and reporting its application	Yes	Refer to Section 3 on page 5 – outlines responsibility for updating, maintaining and applying the CAM.

CAG	Requirement	Addressed	Comments
3.2(a)(4)	Description of corporate and operational structure	Yes	Refer to Section 4 on pages 5-6 – describes corporate and organisation structure, including key responsibilities of each area of the business.
3.2(a)(5)	Specification of service categories and types of persons to whom services provided	Yes	Refer to Section 5 on page 7 – specifies service categories and to who services are provided.
3.2(a)(6)	Principles and policies for attributing costs to, and allocating costs between, categories of distribution services in accordance with clause 2.2 of CAG – refer to separate table below	Yes	Refer to Section 6 on pages 7-20 – sets out cost allocation policies and procedures – and separate table below.
3.2(a)(7)	Description of how will maintain records of attribution and allocation	Yes	Refer to Section 7 on pages 20-21 – describes how Ausgrid will maintain records of cost attribution and allocation.
3.2(a)(8)	Description of how will monitor compliance with CAM and Guidelines	Yes	Refer to Section 8 on page 21 – includes responsibility for governance and sign-off of the CAM and measures through which Ausgrid will monitor compliance.
3.2(a)(9)	Commencement date	Yes	Refer to Section 9 on page 21 – notes date CAM will formally come into effect.

4.3 Cost allocation principles and policies

Rules	CAG	Requirements	Addressed	Comments
6.15.2(1)	2.2.1(a)	<p>Include sufficiently detailed principles and policies for attributing costs to, and allocating costs between, categories of distribution services to enable:</p> <p>AER to replicate reported outcomes</p> <p>DNSP to demonstrate that it is meeting requirements</p>	Yes	<p>The CAM provides detailed commentary on the cost allocation principles and policies to enable the AER to replicate reported outcomes and the DNSP to demonstrate that it is meeting requirements. For example:</p> <ul style="list-style-type: none"> • Section 6.1 provides an overview of Ausgrid's cost hierarchy and cost disaggregation • Section 6.5 details the procedures by which costs are directly attributed for operating and capital expenditure to relevant service categories • Section 6.6 details how shared costs are allocated to services based on appropriate causal and non-causal allocators • Table in section 6 provide detailed breakdowns of the attribution and allocation of different types of costs
	2.2.1(b)(1)	<p>Include specified information on directly attributable costs to enable AER to replicate reported outcomes</p>	Yes	<p>Refer to Section 6.5 on pages 11-14 - includes detailed information on directly attributable costs.</p>
	2.2.1(b)(2)	<p>Include specified information on shared costs to enable AER to replicate reported outcomes</p>	Yes	<p>Refer to Section 6.6 on pages 14-19 – reported outcomes can be replicated when CAM is used in conjunction with accounting records.</p>

Rules	CAG	Requirements	Addressed	Comments
6.15.2(2)	2.2.2	Attribute costs directly to, or allocated costs between, categories of distribution services based on substance of underlying transaction or event not legal form	Yes	Refer to Section 6
6.15.2(3)(i)	2.2.3	Only directly attribute costs to categories of distribution services if they are directly attributable to the provision of the service	Yes	Refer to Section 6.5 on pages 11-14
6.15.2(3)(ii)	2.2.4	Allocate shared costs between categories of distribution services using an appropriate causal allocator, except to the extent that: Shared cost is immaterial Causal relationship cannot be established without undue cost or effort in which case may use non-causal allocator in specified circumstances	Yes	Refer to section 6.6 on pages 14-19 - describes causal and non-causal principles of allocators. Tables set out the basis of allocation, whether the allocation is causal or non-causal and the reason for the allocator chosen.
6.15.2(4)		Clearly describe the cost allocation method, the reason for using it and the numeric quantity (if any) of the chosen allocator	Yes	Refer to section 6 – as above Tables in this section set out the basis of allocation, whether the allocation is causal or non-causal and the reason for the allocator chosen. Numeric quantities are not given but examples of how allocations are calculated are provided.

Rules	CAG	Requirements	Addressed	Comments
6.15.2(5)	2.2.5	Do not allocate the same cost more than once	Yes	Refer to Section 2 on page 4 – sets out the Cost Allocation Principles followed to prepare the CAM and makes reference to this requirement.
6.15.2(6)	2.2.6	Detailed principles, policies and approach used to attribute costs directly to, or allocated costs between, categories of distribution services must be consistent with the Distribution Ring Fencing Guidelines	Yes	Refer to Section 2 on page 4 – sets out the Cost Allocation Principles followed to prepare the CAM and makes reference to this requirement.
6.15.2(7)	2.2.7	Costs that have been attributed or allocated costs to distribution services must not be reattributed or reallocated to another service during the regulatory control period	Yes	Refer to Section 2 on page 4 – sets out the Cost Allocation Principles followed to prepare the CAM and makes reference to this requirement.

4.4 Conclusion

On the basis of our findings detailed in sections 4.1 to 4.3 above, we conclude that Ausgrid's proposed Cost Allocation Method meets the regulatory requirements of:

- Part F of the new Chapter 6 of the NER; and
- the AER's Cost Allocation Guidelines.

We therefore do not consider that the AER needs to require Ausgrid to make any changes to its proposed Cost Allocation Method in order to approve it as complying with the relevant regulatory requirements.